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National Costs Of The Medical Liability System

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ABSTRACT **Concerns about reducing the rate of growth of health expenditures have reignited interest in medical liability reforms and their potential to save money by reducing the practice of defensive medicine. It is not easy to estimate the costs of the medical liability system, however. This article identifies the various components of liability system costs, generates national estimates for each component, and discusses the level of evidence available to support the estimates. Overall annual medical liability system costs, including defensive medicine, are estimated to be $55.6 billion in 2008 dollars, or 2.4 percent of total health care spending.**

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During the push to pass federal health reform legislation, considerable attention focused on the possibility that medical liability reforms could "bend the health care cost curve."[1–3] Conservatives in Congress and others argued that liability reform would address two drivers of health care costs: providers' need to offset rising malpractice insurance premiums by charging higher prices, and defensive medicine—clinicians' intentional overuse of health services to reduce their liability risk. President Barack Obama elevated the profile of liability reform by acknowledging that "defensive medicine may be contributing to unnecessary costs" and by authorizing demonstration projects to test reforms.[4,5]

Background

PREVIOUS ANALYSES Notwithstanding this interest in liability reform, rigorous estimates of the cost of the medical liability system are scarce. The most commonly cited figures are from a 2004 Congressional Budget Office (CBO) report that concluded, based on unspecified data provided by a private actuarial firm and the Centers for Medicare and Medicaid Services (CMS), that malpractice costs—excluding defensive medicine—account for less than 2 percent of health care spending.[6]

In a subsequent analysis, PriceWaterhouseCoopers used the 2 percent figure, then extrapolated from estimates of the practice of defensive medicine in a study of care for two cardiac conditions by Dan Kessler and Mark McClellan.[7] On that basis, the firm reported that the cost of insurance and defensive medicine combined account for approximately 10 percent of total health care costs.[8] More recently, the CBO concluded that implementing a package of five malpractice reforms would reduce national health spending by about 0.5 percent[9] but did not estimate total malpractice costs.

CURRENT ANALYSIS In this article we estimate the cost of the medical liability system in order to better understand its potential to affect overall health spending. We break down the various components of liability system costs, use the best available data to generate national annual estimates for each component, and discuss the quality of the evidence available to support these estimates.

▶ **LIMITATIONS:** Our analysis was limited in two key respects. First, we did not attempt to estimate social costs that cannot be readily expressed in monetary terms. For example, we did not include the reputational and emotional costs for physicians of being sued. Second, we did not evaluate the social benefits of the medical liabil-

ity system, of which there are arguably at least three types.

▶ **SOCIAL BENEFITS OF THE LIABILITY SYSTEM:** The system makes injured patients whole by providing compensation; it provides other forms of "corrective justice" for injured persons, which produces psychological benefits; and it reduces future injuries by signaling to health care providers that they will suffer sanctions if they practice negligently and cause injury.

However, it is not possible to quantify these benefits. Reliable evidence about the deterrent effect of the tort system does not exist.[10] With respect to the benefits flowing from the tort system's compensation and corrective justice functions, not only is no evidence available, but it is not clear how to measure them. Although these benefits cannot be quantified, they certainly exist, and they should be considered in discussions of the social value of liability. The economic burden of preventable medical injuries is considerable, estimated to be $17–$29 billion per year,[11] and improving patient safety is important whether or not the improvement is achieved in part through malpractice litigation.

▶ **PURPOSE:** Our purpose in this analysis was not to examine whether the medical liability system is worth maintaining, meaning whether its costs are justified by its benefits. Rather, we sought to understand the extent to which it contributes to health care spending.

Components Of Medical Liability System Costs

The total monetizable costs of the medical liability system—those that can be quantified and expressed in monetary terms—can be divided into several components (Exhibit 1). The major categories of costs are indemnity payments, or the amounts that malpractice defendants, typically through their liability insurers, pay out to patients who file malpractice claims against them; administrative expenses, consisting of attorneys' fees and other legal expenses for both sides, plus insurer overhead; defensive medicine costs, which are the costs of medical services ordered primarily for the purpose of minimizing the physician's liability risk; and other costs, some of which are difficult or impossible to quantify in economic terms. All costs are presented in 2008 dollars.

Notably missing from this list are malpractice insurance premiums. Premiums represent insurers' best estimates of their indemnity costs and defense costs, plus additional amounts to cover other operating expenses, reinsurance costs, and profits or surplus building. It would be double counting to include both malpractice premium costs and indemnity and administrative costs.

We took the approach of itemizing indemnity and administrative costs rather than reporting total premium costs for two reasons. Profits are not part of the costs of paying malpractice claims or operating the necessary administrative struc-

EXHIBIT 1

Estimates Of National Costs Of The Medical Liability System

Component	Estimated cost (billions of 2008 dollars)	Quality of evidence supporting cost estimate
Indemnity payments	$5.72	Good as to the total; moderate as to the precision of the split among the components
Economic damages	$3.15	
Noneconomic damages	$2.40	
Punitive damages	$0.17	
Administrative expenses	$4.13[a]	Moderate
Plaintiff legal expenses	$2.00[a]	Good
Defendant legal expenses	$1.09	Moderate
Other overhead expenses	$3.04	Good
Defensive medicine costs	$45.59	Low
Hospital services	$38.79	
Physician/clinical services	$6.80	
Other costs		
Lost clinician work time	$0.20	Moderate
Price effects	–[b]	Low
Reputational/emotional harm	–[b]	No evidence
Total	$55.64	

SOURCE Authors' analysis. [a]Although plaintiff legal expenses are separately itemized, they are not included in the overall administrative costs total because, in the contingent fee system, they are already represented in the indemnity costs. [b]These costs are not estimable with the available data.